STATE OF INDIANA

DEPARTMENT OF FINANCIAL INSTITUTIONS

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November 7, 2003

Coreen S. Arnold
District Counsel, Central District
Office of the Comptroller of the Currency
One Financial Place, Suite 2700
440 South LaSalle Street
Chicago, IL 60605

Subject: National City Bank of Indiana, Indianapolis, Indiana, Request for the Opinion of the Comptroller of the Currency on the Applicability of Indiana Code Section 24-4.5-3-402 Restricting Home Equity Balloon Loans

Dear Ms. Arnold:

The Indiana Department of Financial Institutions ("IDFI") appreciates this opportunity to respond to the Request for the Opinion of the Comptroller of the Currency on the Applicability of Indiana Code Section 24-4.5-3-402 Restricting Home Equity Balloon Loans. Our staff has reviewed Mr. Plant's letter and disagrees with both his interpretations and conclusions in multiple areas.

Mr. Plant is seeking confirmation from the Office of the Comptroller of the Currency ("OCC") on National City's opinion that neither the bank nor its mortgage subsidiaries are required to comply with Section 24-4.5-3-402 of the Indiana Code. In his letter, Mr. Plant references several OCC Interpretive Letters, and primarily bases his argument on provisions contained within 12 C.F.R 34 as promulgated by the OCC. He specifically argues 12 C.F.R. §§ 34.4(a)(2) and 34.4(a)(3), cited within below:

§ 34.4 Applicability of State law.

(a) Specific preemption. A national bank may make real estate loans under 12 U.S.C. 371 and § 34.3 without regard to State law limitations concerning:

(1) The amount of a loan in relation to the appraised value of the real estate;

(2) The schedule for the repayment of principal and interest;

(3) The term to maturity of the loan;
(4) The aggregate amount of funds that may be loaned upon the security of real estate; and
(5) The covenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan.

In his letter, Mr. Plant points to the above cite in support of his contention that 12 C.F.R. 34 "specifically preempt[s] state laws which affect these lenders' [meaning banks and their subsidiaries] ability to originate balloon loans." He draws this conclusion despite the clear wording of the regulation that renders § 34.4 applicable only to *national banks*, with no mention of their *subsidiaries*. Mr. Plant has apparently taken it upon himself to add the phrase "and their subsidiaries" to this regulation. His inference is rendered particularly misplaced when a review of additional sections of Part 34 reveals sections in which the OCC specifically included subsidiaries. For example, 12 C.F.R. 34.21, in part, reads as follows:

> § 34.21 General rule.
> (a) Authorization. A national bank and its subsidiaries may make, sell, purchase, participate in, or otherwise deal in ARM loans and interests therein without regard to any State law limitations on those activities.

It is clear that, in drafting Part 34, the OCC intentionally included bank subsidiaries in certain sections, and excluded them in others. Mr. Plant is certainly in no position to simply insert these words as he sees fit into a properly promulgated federal regulation. It is thus clear that § 34.4 is not applicable to the subsidiaries of national banks.

Beyond the simple fact that Mr. Plant is engaging in selective reading of Part 34, the notion that these operating subsidiaries, both of which are creations of state law, would not be required to comply with consumer protection laws enacted by the Indiana legislature, based simply on their ownership, is clearly contrary to Supreme Court precedent. Such an interpretation would seriously infringe upon the states' sovereign authority over state-chartered corporations, and, in effect, federalize these subsidiaries by subjecting them to the regulatory oversight of the OCC. The Supreme Court has consistently upheld the authority of each state (i) to exercise comprehensive supervision over the corporations it charters, and (ii) to license and regulate corporations chartered by other states that transact business within its borders. Corporations may not, simply by virtue of their ownership by national banks, enjoy the benefits and privileges of state laws, while avoiding the inherent obligations and restrictions therein.

Next we consider whether § 34.4, and specifically §§ 34.4(a)(2) and 34.4(a)(3) render Section 24-4.5-3-402 of the Indiana Code preempted with respect to National City Bank of Indiana. Mr. Plant contends that "§§ 34.4(a)(2) and 34.4(a)(3) specifically preempt state laws which affect . . . lenders' ability to originate balloon loans." The actual wording of the regulation does nothing of the sort. Indeed, if the provisions so specifically preempted state laws relating to balloon payments, why did Mr. Plant feel compelled to seek OCC confirmation? He takes the position, and cites OCC Interpretative Letters in support thereof, that if a state includes consumer protection provisions in its statutes that are triggered by a lender's invocation of a balloon payment provision, national banks may ignore these consumer protection measures. Presumably this is because these balloon payment provisions are viewed as either a limitation on the schedule for the repayment of principal and interest, or a limitation on the term to maturity of the loan. In truth, Section 3-402 is not a limitation on either of these provisions.

The provisions included in § 34.4 relate to traditional safety and soundness issues related to loan structure. Section 3-402 is included in the Indiana Consumer Credit Code. It was promulgated as a consumer protection measure, similar to a usury ceiling. The statute's language provides a consumer protection provision that is triggered in the event a lender chooses a loan structure that results in a large balloon payment. Section 3-402 does not limit a bank's schedule for the repayment of principal and interest. Banks are free to structure their loans as they see fit. And the statute does not limit the term to maturity that a lender may choose. Rather, Section 3-402 adds a measure of consumer protection in the event that, in determining its terms and repayment schedule, the lender chooses a loan product that has historically raised significant consumer protection concerns.

Congress has previously voiced its intent that national banks are not immune from application of state laws, and particularly those related to consumer protections. The House-Senate conference committee report on the 1994 Riegle-Neal Interstate Branching and Bank Efficiency Act stated that: "States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses and communities."

Ms. Arnold, for the reasons stated above, the IDFI is of the strong opinion that Section 3-402 applies to both National City Bank of Indiana and its mortgage subsidiaries. You stated that you would be responding soon to Mr. Plant. We ask that you copy the IDFI in your response. In the meantime, please contact me or Phil Goddard, DFI Chief Counsel, at (317) 232-5837, with any questions.

Sincerely,

Charles W. Phillips
Director

c: Senator Richard G. Lugar
Senator Evan Bayh, Member, U.S. Sen. Comm. on Banking, Housing, & Urban Affairs
Congresswoman Julia Carson, Member, U.S. House Comm. on Financial Services
Joseph E. Kernan, Governor, State of Indiana
Senator Allen E. Paul, Chairman, Insurance and Financial Institutions Comm., Indiana General Assembly
Representative Jeb Bardon, Chairman, Financial Institutions Comm., Indiana General Assembly
Representative Woody Burton, Member, Financial Institutions Comm., Indiana General Assembly
Steven Carter, Attorney General, State of Indiana
Todd Rokita, Secretary of State, State of Indiana
Neil Milner, President & CEO, Conference of State Bank Supervisors
Indiana State-Chartered Banks (129)

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INDIANA DEPARTMENT OF FINANCIAL INSTITUTIONS

Comptroller of the Currency
Administrator of National Banks

Central District Office
440 S. LaSalle St., Suite 2700
Chicago, IL 60605

October 17, 2003

Charles W. Phillips, Director
Indiana Department of Financial Institutions
30 S. Meridian Street, Suite 300
Indianapolis, IN 46204

Subject: National City Bank of Indiana, Indianapolis, Indiana, Request for the Opinion of the Office of the Comptroller of the Currency on the Applicability of Indiana Code Section 24-4.5-3-402 Restricting Home Equity Balloon Loans

Dear Mr. Phillips:

Enclosed please find a letter from Thomas A. Plant, on behalf of National City Bank of Indiana, Indianapolis, Indiana ("Bank"), requesting the confirmation of this office that Federal law preempts the laws of Indiana that purport to restrict the Bank and its mortgage subsidiaries from establishing and enforcing balloon payment terms on loans originated for subordinate lien mortgages. Specifically, Mr. Plant seeks an opinion on the applicability of Indiana Code Section 24-4.5-3-402.

We will be preparing a response to Mr. Plant's request shortly and, in doing so, would like to consider any comments you may have. We would appreciate receiving your comments by October 31, 2003. If you have any questions or need additional information, please contact me or Giovanna Cavallo, an attorney on my staff, at (312) 360-8805.

Sincerely,

Coreen S. Arnold
District Counsel

Enclosure

National City

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Thomas A. Plant
Senior Vice President
Assistant General Counsel
Law Division

September 11, 2003

Coreen Arnold
District Counsel, Central District
Office of the Comptroller of the Currency
One Financial Place, Suite 2700
440 South LaSalle Street
Chicago, IL 60605

Re: Request for Confirmation that a National Bank and its Operating Subsidiaries Are Not Required to Comply with Indiana Code Section 24-4.5-3-402 Restricting Home Equity Balloon Loans

Dear Ms. Arnold:

On behalf of National City Bank of Indiana ("Bank") and its operating subsidiaries First Franklin Financial Corporation and National City Mortgage Co. (collectively "Mortgage Subsidiaries"), we hereby request the Office of the Comptroller of the Currency ("OCC") confirm our opinion that the Bank and Mortgage Subsidiaries are not required to comply with Section 24-4.5-3-402 of the Indiana Code which restricts balloon lending when they originate subordinate lien mortgages under the authority of 12 U.S.C. § 85 and 12 C.F.R. § 7.4001.

Bank has its main office in Indianapolis, Indiana and has no branches outside of Indiana (herein referred to as the Bank's "home state"). The Mortgage Subsidiaries are wholly owned operating subsidiaries of the Bank. The Bank and its Mortgage Subsidiaries plan to originate subordinate lien residential mortgage loans on a uniform nationwide basis using the rate and fee authority of the home state, Indiana, pursuant to 12 U.S.C. § 85 and 12 C.F.R. § 7.4001. See Unpublished Opinion of Julie L. Williams to Thomas A. Plant dated July 21, 2003.

Home equity lending in Indiana is governed by the Indiana version of the Uniform Consumer Credit Code, Ind. Code § 24-4.5-1-101 et. seq. (the "ICCC"), which contains provisions regulating the interest rate, fees and charges for those loans. Another section of the ICCC, Ind. Code § 24-4.5-3-402 ("Section 3-402"), provides that a lender must permit a borrower, upon request, to refinance any balloon payment provision in a home equity loan at terms no less favorable than the original loan. Section 3-402 provides:

> Balloon payments
>
> (1) With respect to a consumer loan, other than one pursuant to a revolving loan account or one on which only loan finance charges are payable prior to the time that the final scheduled payment is due, if any scheduled payment is more than twice as large as the average of earlier scheduled payments, the debtor has the right to refinance the amount of that payment at the time it is due without penalty. The terms of the refinancing shall be no less favorable to the debtor than the terms of the original loan. This section does not apply to the extent that the payment schedule is adjusted to the seasonal or irregular income of the debtor.
>
> (2) For the purposes of this section, "terms of the refinancing" means:
>
> (a) in the case of a fixed-rate consumer loan, the individual payment amounts, the charges as a result of default by the debtor, and the rate of the loan finance charge; and

(b) in the case of a variable rate consumer loan, the method used to determine the individual payment amounts, the charges as a result of default by the debtor, the method used to determine the rate of the loan finance charge, the circumstances under which the rate of the loan finance charge may increase, and any limitations on the increase in the rate of the loan finance charge.

Twelve U.S.C. 371(a) of the National Bank Act, enacted as part of the Garn-St.Germain Depository Institutions Act ("Garn-St.Germain"), provides as follows:

> Authorization to make real estate loans; orders, rules and regulations of Comptroller of the Currency. Any national banking association may make, arrange, purchase or sell loans or extension of credit secured by liens on interests in real estate, subject to section 18(o) of the Federal Deposit Insurance Act [12 USCS §1828(o)] and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.

The OCC fully implemented the authority granted by Garn-St. Germain in 1983 by promulgating Part 34, which comprehensively defines real estate lending by national banks and their operating subsidiaries. Part 34 also clarifies the scope of federal preemption of state laws that could impact real estate lending activities by national banks and national bank operating subsidiaries, and 12 C.F.R. §§ 34.4(a)(2) and 34.4(a)(3) specifically preempt state laws which affect these lenders' ability to originate balloon loans:

> § 34.4 Applicability of State law.
> (a) Specific preemption. A national bank may make real estate loans under 12 U.S.C. 371 and § 34.3 without regard to State law limitations concerning:
> (1) The amount of a loan in relation to the appraised value of the real estate;
> (2) The schedule for the repayment of principal and interest;
> (3) The term to maturity of the loan;
> (4) The aggregate amount of funds that may be loaned upon the security of real estate; and
> (5) The covenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan.

The OCC staff has consistently opined that state limitations on balloon payment loans are preempted pursuant to 12 C.F.R. § 34.4. Two OCC staff interpretive letters have addressed balloon payment restrictions under a Massachusetts statutory provision, Mass. Gen. Laws Ann. Ch. 183, § 60, which is similar to Section 3-402 of the ICCC and found that they are preempted by 12 USC § 371 and 12 C.F.R. Part 34. See OCC Staff Interpretative Letters dated December 8, 1983 and August 24, 1987. In addition, another OCC staff interpretative letter found that an analogous provision in the Pennsylvania Banking Code, Pa. Stat. Ann. tit. 7, §310(a), was preempted by the same federal law and OCC regulation. See OCC Staff Interpretative Letter dated September 30, 1992.

Our research has also found two other letters which considered provisions from the Kansas and the Colorado versions of the Uniform Consumer Credit Code which are almost identical to Section 3-402 of the Indiana Code. See OCC Staff Interpretive Letters dated January 24, 1990 and October 30, 1990. In each letter, the OCC staff concluded that the restrictions on balloon payments under these provisions of the Uniform Consumer Credit Code were preempted as to national banks. The January 24, 1990 letter acknowledged that the preemption was only necessary for subordinate mortgage lending. These letters are consistent with an OCC Staff

Interpretive Letter dated September 27, 1984, in which Jonathan Levin, Senior Attorney in the Legal Advisory Services Division responded to a request by a national bank located in Colorado for clarification of the impact of C.R.S. § 5-3-402, the Colorado version of Section 3-402 of the Uniform Consumer Credit Code. Mr. Levin concluded that C.R.S. § 5-3-402 was completely preempted for subordinate-lien mortgage loans originated by national banks by reason of 12 U.S.C. § 371 and 12 C.F.R. Part 34.

While these OCC staff interpretive letters have not specifically discussed 12 U.S.C. § 85 and 12 C.F.R. § 7.4001, we also believe a national bank or operating subsidiary that uses Indiana interest rates and charges is also not required to comply with Section 3-402. The OCC has recognized that the balloon lending restrictions are preempted in situations involving subordinate lien loans, where a national bank would certainly rely on state interest rate laws for rate authority. Twelve C.F.R. § 34.4 provides that national banks and their operating subsidiaries may make home equity loans without regard to state statutes that regulate the schedule for repayment of principal and interest and the term to maturity of the loan; therefore, such lenders are not required to comply with balloon payment limitations when using 12 U.S.C. § 85.

For the reasons expressed above, we respectfully request that the OCC confirm that the Bank and the Mortgage Subsidiaries are not be restricted by the balloon payment provisions of Ind. Code § 24-4.5-3-402 when they originate home equity loans pursuant to Indiana law on a nationwide basis under the authority of 12 U.S.C. § 85.

Very truly yours,

Thomas A. Plant

TAP/gs